No. 2691.

IN THE

# United States

# Circuit Court of Appeals

## FOR THE NINTH CIRCUIT.

Security Trust & Savings Bank, a corporation, as Trustee in Bankruptcy of Fielding J. Stilson Company, a corporation, Bankrupt,

*Appellant,*

*vs.*

William R. Staats Company, a corporation, and Title Insurance and Trust Company, a corporation,

*Appellees.*

## APPELLEES' PETITION FOR REHEARING.

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## APPELLEES' PETITION FOR REHEARING.

*To the Honorable, the Judges of the United States Circuit Court of Appeals for the Ninth Circuit:*

The appellees in the above-entitled cause respectfully petition for a rehearing.

With all due respect to the court, we are convinced that the court has fallen into grievous error in its decision on the questions of law presented, and thereby has not only established a bad precedent but that its decision will, if allowed to stand, work a most grievous

injustice upon the parties to this cause. It may be that counsel for appellees themselves were guilty of an error of judgment in not arguing the case orally to the court. We attempted to present the matter clearly in our brief and felt that the legal soundness, as well as the justice, of the decision of the learned District Court was so clear that we would hardly be warranted in consuming the time of the court in an oral argument. From the opinion rendered, however, we must have failed in our brief to elucidate clearly the legal questions involved, and also the facts disclosed by the somewhat voluminous record, for we cannot believe that if we had made them clear the court would have rendered such a decision as it has. We shall endeavor, therefore, with all due respect to the court, and as briefly as consistent with the importance of the case, to point out what we conceive to the the errors of law and misconceptions of fact in the decision heretofore rendered.

**As we Read the Opinion, the Court Concedes that the Staats Company Surrendered or "Abandoned" its Right to Retake the Stock When it Accepted the Note and Deed of Trust. Irrespective of Everything Else, this Constituted a "Present Fair Consideration" Which Prevents the Transaction From Being a Preference, and Prevents it From Being Set Aside.**

We shall consider this matter first, although somewhat out of its logical order. In connection with this matter the court says in its opinion (latter part):

"That part of the argument made by the appellees in support of the action of the District Court wherein

the point is made that the giving of the check by the Stilson Company was a representation that that corporation had sufficient funds to meet the check, and that, such representation not being true, a fraud was perpetrated on the Staats Company, and that title remained in the Staats Company and did not pass until the note and deed of trust were accepted, has received our careful consideration. But whatever right of rescission existed because of misrepresentation by the Stilson Company in giving the check, *was abandoned by the position taken when security was accepted for the purchase money.*"

That this right was abandoned or released by taking, and when we took, the security is of course true. *But by the very fact of abandoning or releasing this right to retake the stock we gave a "present fair consideration" for the note and deed of trust.* We respectfully submit that there can be no escape from this conclusion. We had a right to take back the stock. The stock was worth at least as much as (indeed the stock and due bill together were worth a great deal more than) the amount of the note to secure which the deed of trust was given. We released and surrendered the right to retake the stock and permitted title to it to pass, in consideration of the execution and delivery of the note and deed of trust. How can it possibly be contended, therefore, that we did not give a present fair consideration for the note and deed of trust?

Section 67e of the Bankruptcy Act provides that transfers or encumbrances for a present fair considera-

tion are not invalid. Authorities might be multiplied almost without number to the proposition decided in *Cook v. Tullis,* 18 Wall. 332, that: "A fair exchange of values may be made at any time, even if one of the parties is insolvent." See also *McDonald v. Clearwater,* 164 Fed. 1011.

Having a right to take back the stock, which was worth as much as if not more than the security, there could not be, and was not, we submit, any preference in our taking a note and security therefor not greater in amount than the value of that which we had the right to retake. If we chose to exercise our right to take back the stock, the Stilson Company, or the bankrupt estate, would not have owed us anything, *but would have been deprived of stock of the value of at least as great as the amount of the note.* If we had sold it the stock, taking a note secured by a mortgage or deed of trust for its value, there could not possibly be any preference. This was in effect exactly what we did. We allowed it to purchase the stock, and passed title thereto, which we would otherwise have had the right to retake, in consideration of the execution of the note and deed of trust. Everything is apparently conceded in the opinion of the court except the conclusion, which is not mentioned. We feel it must be that we failed to make clear to the mind of the court the point we are now urging, for the conclusion seems to us to follow inevitably.

The authorities cited by us in our brief clearly establish that we had the right to take back the stock. This right existed on any one of three grounds: 1st. That the sale being a cash transaction, title did not pass

until actual payment, and therefore that title did not pass in contemplation of the law until the note and deed of trust were accepted. 2nd. Possession of the stock having been obtained by Stilson's fraud in giving a bad check, no title passed. 3rd. Even if it were true that title had passed, nevertheless by reason of the fraud in giving a bad check we had the right to rescind the transaction and take back the property.

It has never been questioned, and is not, we understand, questioned by the opinion of this court, that the transaction was a cash transaction. It was expressly so found by the Master [Tr. p. 42] where he says "the sale was a cash transaction," and it cannot of course be questioned. The authorities cited by us in our brief, pages 7 to 14, inclusive, establish beyond the question of a doubt that where a sale is a cash transaction no title passes, even though possession does pass, until actual payment of the money, and the fact that a check is given does not affect this rule. In our brief we reviewed a number of these authorities at considerable length. None of them are referred to in the opinion, nor indeed is this proposition of law but barely mentioned. We respectfully urge the court to read the pages of our brief indicated and the authorities there cited in connection with this petition. We would particularly call attention to the statement of law in the case of *Sprague Company v. Fuller*, 158 Fed. 588, decided by the Circuit Court of Appeals of the Fifth Circuit. That case involved a sale of machinery for cash, possession having been delivered. The vendee was declared bankrupt, he not having made payment. In holding that the vendor had the right to retake the property, the court said:

"We concur with the learned district judge that 'there is no doubt about the proposition that, where personalty is sold for cash on delivery, the payment stipulated for is a condition precedent, and, unless complied, the seller may reclaim the property.' We think it is settled law that ' " 'where the buyer is by the contract bound to do anything as a condition, either precedent or concurrent, on which the passing of the property depends, the property will not pass until the condition be fulfilled, even though the goods may have been actually delivered into the possession of the buyer.' Benjamin on Sales (3d Ed.), Sec. 320." ' And it has been held by controlling authority that, where goods were sold to be paid for in cash or securities on delivery, 'the sales were conditional only, and that the vendors were entitled to retake the goods, even after delivery, if the condition was not performed, the delivery being considered as conditional.' " (Citing Harkness v. Russell, 118 U. S. 663, where, after an elaborate review of the authorities, it is so decided.)

All of the authorities cited in our brief show that the effect of a cash sale where possession is delivered and payment is not in fact made is practically that of a conditional sale. The authorities are all to the effect that title remains in the vendor until the price is actually paid and hence the retaking of the property or accepting payment of its value does not and cannot constitute a preference.

The latest decision with which we are familiar is *Bailey v. Baker Ice Machine Co.,* decided by the Supreme Court of the United States November 29, 1915, and reported in U. S. Supreme Court Advance Opin-

ions at page 50. It there held that the taking back of the property so sold, even from a bankrupt, cannot constitute a preference. Of course since the taking back of the property does not constitute a preference, the acceptance of its value either in money or in a secured note, cannot constitute a preference. Hewitt v. Berlin Machine Wks., 194 U. S. 296, is another decision squarely in point.

As a matter of fact we believe it cannot be doubted under the authorities that no title whatever passed until the note and mortgage were accepted, and therefore the transaction was in legal effect exactly the same as if we had sold the property upon condition that they execute the note and mortgage, which no one could contend would constitute a preference. We desire again to point out that this is not even mentioned in the opinion unless the language first quoted can be deemed a mention of it.

But entirely irrespective of this point, since we had the right to take back the property for the other reasons heretofore stated, the surrender of that right constituted a present fair consideration of the note and deed of trust. The court does not attempt to refute the proposition urged by us that the Stilson Company perpetrated a fraud on us by giving a check which was not good. Under the authorities cited in our brief it cannot, we submit, be questioned that this constituted a fraud. It is the settled law of California, as well as the general law, that where property is so obtained by fraud no title passes. See particularly *Amer v. Hightower,* 70 Cal. 440. For this reason again we had the right to take back the property, and the title

did not pass and the sale was not in legal contemplation made until the note and deed of trust were given and accepted. At this moment and not before the sale was consummated and title passed. But even assuming that title did pass, certainly by reason of this fraud we had the right to rescind the transaction and take back the stock, and the surrender of this right was a present fair consideration.

We feel that it is not an unfair statement to say that these points are not considered at all in the opinion of the court. Certainly there is no discussion whatever of the legal principles involved. As before stated, we feel that it must be true that we did not discuss them at sufficient length in our brief to make our point clear, but we trust that we have here presented it so that the court will appreciate the force of the point.

**The Sale was Not Made in Contemplation of Law and Title Did Not Pass Until the Note and Deed of Trust were Executed and Accepted, for Two Reasons: First, the Sale Being a Cash Transaction, Title Did Not Pass Until Actual Payment or Until our Acceptance of the Note and Deed of Trust in Lieu of Payment in Cash. Second, Possession Having Been Secured by the Fraudulent Representation of Stilson in Giving a Bad Check, he Acquired No Title Until we Accepted the Note and Deed of Trust in Lieu of the Cash.**

In the discussion of the first point urged in this petition we have necessarily somewhat covered this point.

As heretofore pointed out the transaction of purchase and sale here involved was a cash transaction.

The law is thoroughly settled that in such a transaction no title passes until payment in cash is actually made, and the giving of a check does not operate to pass title. In our brief, pages 7 to 14, we have reviewed a considerable number of the leading cases establishing this proposition. We desire not unduly to extend the scope of this petition by repeating here what we have set out in the brief, but we refer the court to those pages of our brief, and respectfully urge that Your Honors read the review of the law therein set out. The authorities there cited establish beyond question, we submit, that title to the stock remained in the Staats Company. Title being in that company, it agreed that upon the execution and delivery of the note secured by the deed of trust, title should pass to the Stilson Company. In contemplation of law, therefore, the sale was consummated at that time. The consideration for the passing of title was the secured note. That such a transaction cannot constitute a preference seems to us so clear as hardly to require argument. The stock was worth at least $3870.00. We passed title to it on consideration of the execution and delivery of the secured note, which was worth not more than $3870.00. As heretofore pointed out, the authorities are all to the same effect as Cook v. Tullis, 18 Wallace 332: "A fair exchange of values may be made at any time even if one of the parties is insolvent." We wish again to emphasize that it is not even claimed that the note was for a larger sum than the value of the property. It is admitted that the value of the sixty shares, even eliminating the due bill for 140 shares, was $3870.00, the

amount of the note. This point and the authorities supporting it are not even mentioned in the opinion.

The same result flows from the fact that possession of the property was secured through the fraud of Stilson giving a bad check. As already pointed out, and as shown on pages 15 and 16 of our brief, where possession is so secured by fraud no title passes. That the giving of the bad check constituted fraud cannot be questioned. For this reason also, therefore, title remained in the Staats Company until the secured note was given and accepted. As heretofore pointed out, the transaction was in all substantial respects exactly like a conditional sale, possession being in the vendee and title remaining in the vendor. It is thoroughly settled that in such a case the retaking by the vendor of the property or the acceptance by him of its value is not a preference. Preferences exist only when the estate of the bankrupt is diminished.

> "The preferential transfer must result in the depletion of the debtor's estate, so as to leave the other creditors without property out of which their claims may be paid. If there is no depletion of the estate the creditors cannot complain."
>
> Collier on Bankruptcy, 10th Edition, page 86.

In a case like the one here, it is not diminished, for the vendor gives up the right to retake property of the same value which he receives, and passes title thereto to the bankrupt.

**Even if Every Other Consideration was Resolved Against us the Evidence Does Not Show that the Transaction Constituted a Preference for it Fails to Show that the Effect of the Enforcement of the Note and Deed of Trust Will be to Enable the Staats Company to Secure a Greater Percentage of its Claim than "Any Other Creditor of the Same Class".**

An encumbrance or transfer, even if all other essential elements exist, does not constitute a preference under the statute unless "the effect of the enforcement of such judgment or transfer will be to enable any one of his creditors to obtain a greater percentage of his debt than any other of such creditors of the same class."

Bankruptcy Act, section 60a.

The rule is stated in Collier on Bankruptcy, 10th Edition, page 790, as follows:

> "Since the amendatory act, a preference consists in a person, (1) while insolvent and (2), within four months of the bankruptcy, (3) procuring or suffering a judgment to be entered against himself or making a transfer of his property, (4) the effect of which will be to enable one creditor to obtain a greater percentage of his debt than any other creditor of the same class. Such a preference is voidable at the instance of the trustee, if (5) the person recovering it or to be benefited thereby has (6) reasonable cause to believe that the enforcement of the judgment or transfer will result in a preference."

Of course, it is thoroughly settled as stated by the same author on the same page that

> "The burden of proving the existence of the essential elements of a transfer is upon the trustee seeking to avoid it."

All that the court says about this matter in the opinion in the case at bar is the following:

"The evidence shows that the effect of the enforcement of the mortgage given by the Stilson Company when insolvent would be to give to the defendant, the Staats Company, a greater percentage of its claim against the bankrupt than any other creditors of the same class."

We cannot believe that in making this statement the court appreciated the effect of the record, for with all due respect we submit that it does not at all justify the statement or holding. Even assuming that the Staats Company was an ordinary creditor, or any creditor of the Stilson Company, at the time the note and deed of trust were given, it was necessary for the trustee to prove at least two things in order to meet the burden which was upon it to establish that the note and deed of trust constituted a preference, namely: (1) to show "what other creditors of the same class" would receive; (2) to show how much the Staats Company will receive if the deed of trust is enforced, and that this will be a greater percentage of its debt than "other creditors of the same class" will receive. We respectfully but most earnestly insist that neither was shown. We do not believe there is any competent evidence at all in the record bearing on the question of how much "other creditors of the same class," whatever that may mean in this case, will receive. We know of no evi-

dence in the record except the schedule filed by the bankrupt, and we know of no rule which makes this schedule, which is practically an *ex parte* statement, evidence at all in an independent action such as this. But even assuming that it is evidence, it absolutely fails to furnish the proof which the trustee was required to make. This schedule is set out in the transcript, pages 63 to 107. Its summary set out on pages 63 and 64 shows indebtedness of $257,760.87 and assets of a value of $280,298.11. There was no evidence other than this statement as to the amount of the indebtedness. There was no proof as to the number of claims presented or allowed. Any part of the indebtedness may not be allowable or provable claims. Any amount may be barred by the statute of limitations or subject to other defenses. *There is no evidence at all on these points.* The assets of the company consisted of real property and various items of personal property. Mr. W. W. Eakins, one of the appraisers of the Bankruptcy Court, was called to the stand, and testified that he and his fellow appraisers appraised the real estate owned by the bankrupt and valued the same at $272,125.00. [Tr. p. 210.] It is true that he testified [p. 212] that included in this sum were certain properties claimed to be owned by Fielding J. Stilson, the president of the company, and Mary Stilson, the mother of said Fielding J. Stilson, such properties being valued at $31,500.00. But deducting this sum from the appraisement of the entire properties left a value for the remaining properties of $240,625.00. Said Mary Stilson owed the bankrupt company $13.000.00. [Pp. 128 and 129.] Fielding J. Stilson

himself owed the company $7000.00. [P. 129.] Hence it appeared that they both then owned the property of a value in excess of $31,000.00, and owed the company about $20,000.00. It is only fair to assume that said claims were of some value, the fair assumption being, we submit, that they were worth par. Certainly there is no evidence that they could not be collected. Be that as it may, however, it appears that the real estate alone was of a value in excess of $240,000.00. Of course, if we add the amount owed to the company by Mary Stilson and Fielding J. Stilson, this is brought up to over $260,000.00. The schedule shows a value in stocks and bonds owned by the bankrupt of $10,895.60. [Tr. pp. 102, 104.] The bills, personal notes and securities amounted to $23,802.54. [Tr. pp. 97, 98.] The Oleum Development Company owed the bankrupt $11,040.50. [Tr. p. 100.] This was for money advanced to the corporation in California, and the company had a large number of California stockholders. [Tr. p. 41.] There was no showing that the whole or a large part of this money could not be collected from such stockholders. The company had about $940.00 in cash on hand. [P. 168.] It owned a seat on the Stock Exchange of a value of $1500.00. [P. 169.] There is thus shown a total value of $277,762.00, eliminating entirely the debt owed by the Oleum Development Company, and the debts owed by Fielding J. Stilson and his mother. If these are added there is a total value of assets of about $298,000.00. As we have already shown, it was incumbent upon the trustee to show what other creditors of the same class as the Staats

Company, assuming the Staats Company to be a creditor, would receive. From this review of the evidence, we submit that if any conclusion at all can be drawn, the only fair conclusion is that they will be paid in full or practically in full.

Coming now to the second matter which it was necessary for the trustee to prove, namely, the amount which the Staats Company will receive if the security is enforced, we find the evidence in even a worse situation for the trustee. As a matter of fact, *there is no evidence at all as to the present value of the properties covered by the deed of trust.* The properties on which the deed of trust was taken were covered by first mortgages, which are liens prior to the deed of trust, *and the amount or amounts of those mortgages are not shown.* [Tr. p. 158.] The only evidence in the record as to the value of the property is the statement of Mr. Eakins that in or about January, 1913, he and the other appraisers of the Bankruptcy Court placed certain valuations upon the *fee,* not upon the equity, of these properties. The amount of the first mortgage or prior encumbrance not being shown, this throws no light upon how much will be secured by the Staats Company from the enforcement of the deed of trust. Moreover this valuation was placed in January, 1913; the trial occurred in March, 1914. Any number of things might have occurred in the meantime to depreciate the value of the properties. Changes in business conditions, fires, or any number of things might have intervened to cause a great depreciation. Therefore, this evidence is entirely insufficient to meet the issue. The only other thing in the record that bears

at all on the subject is the statement of Mr. Stilson, appearing on page 158 of the transcript, that in March, 1912, two years before the trial, he told Mr. Coggeshall that the equity in the properties was probably worth from twenty to twenty-five thousand dollars. This was an *ex parte* statement, not under oath, and is, we submit, no evidence at all of the value. Mr. Stilson did not attempt to testify as to the value when he was on the stand.

Bearing in mind that it is essential in order to establish a preference that it be affirmatively proved by the trustee that the enforcement of the security will result in the alleged preferred creditor securing a greater percentage of his claim than other creditors of the same class, we submit there is in this case an absolute failure of proof. How can this court or any court determine, from the evidence here, how much other creditors of the same class as the Staats Company will receive, and how much that company will receive, if the security is enforced? This is true even if we assume that the only claim that the Staats Company had was the claim for $3870.00. As a matter of fact, however, they had outstanding as part of the transaction a due bill for 140 shares of the stock of the Amalgamated Oil Company, which was worth at that time $64.50 per share, or a total of $9030.00. This matter has received no consideration. The fact about to be stated does not appear on the record for the reason that it has developed since the trial, but we feel it is appropriate nevertheless to call it to the court's attention as strikingly illustrating the failure of proof in this case. *The fact is that there is now pending against*

*the Staats Company a suit based on this very due bill.* The case has not been decided but the action has been commenced and is pending. How can this court, or any court, say, from the evidence in this record, how much other creditors of the same class will secure, unless indeed it should hold that from the evidence the only fair inference is that they will be paid in full? How can it say how much will be secured by the Staats Company from the enforcement of this deed of trust, or that it will receive a greater percentage of its debt than other creditors of the same class?

We respectfully submit that there is absolute failure of proof upon this vital and essential point.

This is true even if we accept the position strongest in favor of the trustee and consider the Staats Company as a creditor. Under such view who are creditors "of the same class"? This language of the statute means something. It is obviously not intended to put every creditor on the same plane. In such a case as this we submit the fair construction to give to the words is creditors who have a right of rescission or a right to take back property sold. If this view be correct there is no evidence at all what other creditors of this class there may be or what they will receive.

But we respectfully urge that the Staats Company was not a creditor at all in the sense the word is used in the statute. It stood rather, as we have heretofore shown, in the position of a vendor under a contract of conditional sale. It had parted with possession of certain personal property. It had a right to receive the price thereof, but the title to the property remained in the Staats Company, and it had a right to retake it

if the price was not paid. The taking of possession could not constitute a preference. Hence, security taken in consideration of the surrender of this right and upon which title passed, cannot constitute a preference.

**Irrespective of All the Foregoing Consideration the Court Should Under Settled Principles Consider and Treat the Dealings Between the Staats Company and the Stilson Company as One Transaction, the Net Result of Which was Not to Diminish the Bankrupt Estate, and Which is, Therefore, Not Subject to Attack.**

In our brief, pages 20 to 22, we presented a number of authorities supporting this proposition. It is not even mentioned in the opinion. With all due respect, we are convinced that it is absolutely sound. In our brief we merely cited a number of the leading authorities. The court not having mentioned the point, we crave indulgence briefly to review some of them.

Jaquith v. Eldon, 189 U. S. 78. In this case certain goods and merchandise had been sold and delivered to an insolvent *on credit* and thereafter and while the buyer was insolvent and within four months before the filing of the petition certain payments on account were made and certain additional goods delivered, all on credit. It was held that the payments did not constitute a preference but that the entire matter should be treated as one transaction, the result of which was not to diminish the estate of the bankrupt, and that it was, therefore, not subject to attack.

Wild v. Provident Trust Co., 214 U. S. 292. In this case certain goods had been sold *on credit* after the bankrupt was insolvent and various payments had been made, the last payment being made *after the last delivery of any goods,* and all within four months prior to the filing of the petition. It was held that this did not, and even the last payment did not, constitute a preference, but that the whole dealing should be considered as a single transaction. The court said:

> "The single question in the case is whether that payment was a preference. It is conceded that it would not be a preference, in view of the other facts in the case, if it had been followed by a sale and delivery of goods of any value, however small. This concession is made necessary by the decision in Jaquith v. Alden, 189 U. S. 78, which is, in all respects, like the present case, except that two days after the payment, which was alleged to be a preference, merchandise of trifling value was sold and delivered to the bankrupt. But the decision in that case was not rested upon the fact of this slight sale subsequent to the last payment. *It was rather put upon the broader principle that all the dealings between the creditor and the bankrupt were after the bankrupt's insolvency, and that their net effect was to enrich the bankrupt's estate by the total sales, less the total payments.*" (Italics ours.)

It is to be noted that in both of these cases, the sale was actually made on credit. The case at bar is immensely stronger for us than were these two cases, for here the sale was a cash transaction.

Peterson v. Nash Bros., 112 Fed. 311. This is a decision by the Circuit Court of Appeals of the Eighth Circuit. In this case goods had been sold *on credit* and afterwards and within four months payment on account had been received. It was held that such payments did not constitute a preference, but that the entire dealing should be considered as one transaction.

*In re* Sagor, 121 Fed. 658. This is a decision by the Circuit Court of Appeals of the Second Circuit. This was a very similar case, goods being sold on credit and payment received on account within four months prior to filing of the petition. There is a considerable review of authorities. It was held that the same did not constitute a preference, but that the entire dealing should be regarded as constituting a single transaction.

M'Key v. Lee, 105 Fed. 923. This is a decision by the Circuit Court of Appeals of the Seventh Circuit. The facts were similar and the decision was the same. The court pointed out this was a just and reasonable construction.

> "It leaves the estate unimpaired; for the property of the creditor coming into the debtor's estate is presumably the equivalent of the money value at which it was purchased."

We submit that in the case at bar, even more than any other cases which we have cited, the principle therein announced and followed should be applied. In all the cases we have cited the sale was made on credit. Title passed to the vendee before any payment was made. In the case at bar the sale was a cash trans-

action. No title passed until payment in the form of a secured note was given and accepted. If we assume that the Stilson Company was insolvent at all, all of the dealings occurred after its insolvency, and through the transaction the company secured stock of a value of $3870.00, a due bill for 140 shares of whatever value it had, and became liable to pay only $3870.00. The language of Wild v. Provident Trust Company, *supra*, is directly applicable to the case at bar.

> "But the decision in that case (Jaquith case) was not rested upon the fact of this slight sale subsequent to the last payment. *It was rather put upon the broader principle that all the dealings between the creditor and the bankrupt were after the bankrupt's insolvency, and that their net effect was to enrich the bankrupt's estate by the total sales, less the total payments.*"

Here, if we assume the Stilson Company to have been insolvent at all, "all the dealings between the creditor and the bankrupt were after the bankrupt's insolvency, and their net effect was to enrich the bankrupt's estate" by the difference between the value of the 60 shares of stock plus the due bill for 140 shares, and $3870.00. Certainly the bankrupt's estate was not depleted by the transaction, for even if the due bill were treated as absolutely worthless, the bankrupt received stock worth $3870.00, and only gave a promise to pay the same amount. If it had paid cash for the stock, then under these decisions there can be no question that the payment would have been valid and not preferential. It gave, and the Staats Company accepted, the note simply in lieu of the cash which

the Staats Company might have lawfully received and retained.

The fact that the Staats Company put the check through the bank twice after the first time cannot, we submit, change this rule. Under the principle of the Wild case, that all the transactions occurred after the insolvency—and the net result was to enrich or at least not deplete the bankrupt's estate, this consideration is obviously beside the point. So it is indeed we submit under any view. The Staats Company had a right to the money. The Stilson Company said "if you will put the check through the bank again we will have the money for you." How can it be said that the Staats Company lost any rights by so doing? The check was not payment. Neither did putting it through the bank constitute payment. Title was still in the Staats Company. It cannot be held to have waived any rights by putting it through the bank the second time any more than by putting it through the first time. Certainly the fact that it put the check through the bank the second time did not operate to pass title to the stock any more than the fact that it put it through the first time had such effect. The transaction was such that under the law no title passed until the money was actually received. *Indeed to hold otherwise the court would necessarily have to hold that if the check had been cashed this very fact would have amounted to a preference,* for the note and deed of trust were taken simply in lieu of the cash, to which we were certainly entitled.

The case here presented is very similar to the case of Sawyer v. Turpin, 91 U. S. 114. In that case a bill of sale had been given by the bankrupt which gave to Turpin the right to take possession of the property. Thereafter and within four months prior to the filing of the petition a chattel mortgage was executed by the bankrupt to Turpin in consideration of which he surrendered his bill of sale and right to take possession of the property. It was held that this security did not constitute a preference. The court said:

> "It is too well settled to require discussion, that an exchange of securities within the four months is not a fraudulent preference within the meaning of the Bankrupt Law, even when the creditor and the debtor know that the latter is insolvent, if the security given up is a valid one when the exchange is made, and if it be undoubtedly of equal value with the security substituted for it. This was early decided with reference to the Massachusetts insolvent laws (Stevens v. Blanchard, 3 Cush. 169); and the same thing has been determined with reference to the Bankrupt Act. Cook v. Tullis, 18 Wall. 340; Clark v. Iselin, 21 *id.* 360; Watson v. Taylor, 21 *id.* 378; and Burnhisel v. Firman, 22 *id.* 170. The reason is, that the exchange takes nothing away from the other creditors. It is, therefore, not in conflict with the thirty-fifth section of the act, *the purpose of which is to secure a ratable distribution of the property of a bankrupt owned by him at the time of his becoming bankrupt*, and undiminished by any fraudulent preferences given within four months prior thereto." (Italics ours.)

In the case at bar the Staats Company had a right, as already shown, to take back the stock and in addition still hold title thereto. When it gave up this right and passed title to the stock in exchange for the secured note, the transaction was in effect merely an exchange of securities. Certainly the exchange took "nothing away from the other creditors." Equally it did not infringe on the purpose of the act, which, as stated in the case cited, is to "secure a ratable distribution of the property of a bankrupt owned by him at the time of his becoming bankrupt." The whole transaction, as heretofore pointed out, occurred after the insolvency, if, indeed, the Stilson Company can be considered as having been insolvent at all.

Perkins v. Maier & Zobelin Brewing Co., 133 Cal. 496, is a quite similar case. There a chattel mortgage had been given with a right to take possession upon breach. Possession was taken shortly before insolvency proceedings. It was held as against the assignee in insolvency that the possession dated from the date of the execution of the mortgage, that is, from the date when the right to possession accrued. The case at bar is indeed much stronger than the case cited.

Christ v. Sawyer (Penn.), 61 Atl. 822, is also in point. There a bill of sale was given which gave a right to possession, but possession was not actually taken until within four months of the filing of the petition in bankruptcy. It was held that the taking of possession did not constitute a preference, and amounted to a mere exchange in the form of the se-

curity. The opinion considers the question carefully and cited numerous decisions of the United States Supreme Court.

In the case at bar, as already pointed out, the Staats Company did have security even if it be deemed a creditor, in that it had a right to retake the stock and also held title to the stock. When it surrendered these in consideration for the secured note, it was a mere exchange of securities, which, we submit, cannot be held to constitute a preference.

**The Evidence was Ample to Support the Finding of the Learned District Court that the Staats Company Did Not Have Reasonable Cause to Believe that a Preference was Intended.**

We feel so strongly that the points heretofore discussed are sufficient to entitle us to an affirmance of the judgment that we hesitate to discuss this point at length, but feel that its own merit entitles it, and that fairness to the learned District Court requires us, to make some reference to it. The rule is not that a mere suspicion of insolvency will invalidate a transaction of this character. It must be based on a reasonable cause to *believe*. The rule has never been better stated than by the Supreme Court in Grant v. National Bank, 97 U. S. 80. Here the court says:

> "Some confusion exists in the cases as to the meaning of the phrase, 'having reasonable cause to believe such a person is insolvent.' *Dicta* are not wanting which assume that it has the same meaning as if it had read, 'having reasonable cause to suspect such a person is insolvent.' But the two

phrases are distinct in meaning and effect. It is not enough that a creditor has some cause to suspect the insolvency of his debtor; but he must have such a knowledge of facts as to induce a reasonable belief of his debtor's insolvency, in order to invalidate a security taken for his debt. To make mere suspicion a ground of nullity in such a case would render the business transactions of the community altogether too insecure. It was never the intention of the framers of the act to establish any such rule. A man may have many grounds of suspicion that his debtor is in failing circumstances, and yet have no cause for a well-grounded belief of the fact. He may be unwilling to trust him further; he may feel anxious about his claim, and have a strong desire to secure it,—and yet such belief as the act requires may be wanting. Obtaining additional security, or receiving payment of a debt, under such circumstances, is not prohibited by the law. Receiving payment is put in the same category, in the section referred to, as receiving security. Hundreds of men constantly continue to make payments up to the very eve of their failure, which it would be very unjust and disastrous to set aside. And yet this could be done in a large proportion of cases if mere grounds of suspicion of their solvency were sufficient for the purpose.

"The debtor is often buoyed up by the hope of being able to get through with his difficulties long after his case is in fact desperate; and his creditors, if they know anything of his embarrassments, either participate in the same feeling, or at least are willing to think that there is a possibility of his succeeding. To overhaul and set aside all

his transactions with his creditors, made under such circumstances, because there may exist some ground of suspicion of his inability to carry himself through, would make the bankrupt law an engine of oppression and injustice. It would, in fact, have the effect of producing bankruptcy in many cases where it might otherwise be avoided.

"Hence the act, very wisely, as we think, instead of making a payment or a security void for a mere suspicion of the debtor's insolvency, requires, for that purpose, that his creditor should have some reasonable cause to believe him insolvent. He must have a knowledge of some fact or facts calculated to produce such a belief in the mind of an ordinarily intelligent man."

Now, what were the facts in the case at bar. A check for a very considerable sum of money, over $12,000.00, had been dishonored. It was not like the dishonor of a small check. The company might have had a very large balance in the bank and still not enough to meet a check of this size. Moreover, it was not the first time that this occurred. The Staats Company and the Stilson Company were both brokers in Los Angeles. The evidence shows that several times before in their dealings checks had been dishonored and later been paid out in full. [Tr. p. 195.] The Stilson Company had large holdings of valuable real estate, stocks, bonds and other property, and, as the evidence shows, was actively engaged in business. Its real estate alone was worth approximately a quarter of a million dollars. Its holdings were so large, indeed, that, as heretofore shown, after a judicial hearing it

was extremely doubtful whether it was in fact insolvent. The evidence shows that Mr. Jardine of the Staats Company had made inquiries of leading bankers in Los Angeles as to the financial standing of the Stilson Company and the answer was that they were careless about their business *methods* but were perfectly good and responsible financially [Tr. pp. 194-5], and that the reputation of the company on the Stock Exchange and in financial circles was good. [Tr. pp. 195-6.] Under the rule announced in the Grant case, *supra,* we submit that the evidence was amply sufficient to justify the holding of the learned District Court that the Staats Company did not have reasonable cause to believe that the Stilson Company was insolvent, and should lead this court to make the same finding. We have not here the case of a man or company operating on a "shoe string." On the contrary, here was an established corporation engaged largely in business with visible assets worth approximately a quarter million dollars. A corporation which, indeed, as heretofore pointed out, after a judicial hearing, it was very difficult to say whether or not it was insolvent. Under such circumstances, we submit, there ought to be a great deal more than is shown in the record here before a man should be charged with having a reasonable cause to believe that the same was insolvent. It is true Mr. Stilson himself gave some evidence of conversations with representatives of the Staats Company. Even those conversations, however, simply tended to show temporary financial embarrassment, not by any means insolvency, and it is to be borne in mind

that those conversations were denied by the representatives of the Staats Company. Certainly the trial court, who may be presumed to know the parties and their credibility and the weight to be given to their testimony, respectively, ought to be entitled to much consideration by this court. As we pointed out in our opening brief, page 28 and 29, this case was improperly referred to the master. The parties were entitled to the judgment of the District Court. They were so entitled to such judgment and it was the duty of the District Court to pass judgment on the testimony when it came before him. See authorities cited in appellees' brief, pages 28 and 29. He has done so presumptively with a knowledge of the weight to be given to the testimony of each. Under the state of facts presented by this record, we submit that the court should sustain the determination of the learned district judge that the Staats Company did not have reasonable cause to believe that the Stilson Company was insolvent.

There is one other matter not coming perhaps directly under any of the heads which we have discussed that needs a moment's consideration. In the opinion it is stated that the evidence sustains the finding to the effect that the due bill for 140 shares and also the 60 shares of stock had been hypothecated. We are not sure that this is at all important, but in any event we cannot believe that the fact in the records has been fairly appreciated. The evidence on this subject is the mere statement of Mr. Stilson, appearing on page 136 of the Transcript, that "according to the statement 60 shares and the due bill, making 200, had

been hypothecated." Now, we submit that a purported statement of facts in a schedule is not evidence. Moreover, this was no testimony at all. The law does not contemplate that in making a schedule recitals of business transactions shall be set forth. Even assuming that the schedule might be some evidence as to the amount of the property owned by and the debts owed by the bankrupt, this is all that the law contemplates shall be included in a schedule. Certainly outside recitals can be no more than *ex parte* statements, and not evidence at all as to the outside transactions which they purport to relate.

But even if this was considered evidence that they had been hypothecated there is no evidence at all as to when they were hypothecated *or that they had passed into the hands of a bona fide purchaser for value without notice.* This latter is essential to effect any change in the rights of the Staats Company. We think the matter could only be material as a basis of a claim that the Staats Company no longer had the right to rescind and take back the stock. But it would lose this right *only if the shares had passed to the hands of a bona fide purchaser for value without notice,* and if the trustee made this claim the burden of proof was upon it to establish the facts. On page 19 of our brief we cite several authorities to this effect. It is so fundamental as hardly to require citation of authorities that the defense of *bona fide* purchaser for value without notice is a defense which must be pleaded and proved by the person relying upon it. This is established by authorities almost innumerable. As was

said in Wright-Blodgett Company v. United States, 236 U. S. 397, at page 403 *et seq.*, referring to the defense of *bona fide* purchaser for value (in a case involving a patent to land):

> "But this is an affirmative defense which the grantee must establish in order to defeat the government's right to the cancellation of the conveyance which fraud alone is shown to have induced. The rule as to this defense is thus stated in Boone v. Chiles, 10 Pet. 177, 211, 212: 'In setting it up by plea or answer, it must state the deed of purchase, the date, parties, and contents briefly; that the vendor was seized in fee, and in possession; the consideration must be stated, with a distinct averment that it was *bona fide* and truly paid, independently of the recital in the deed. Notice must be denied previous to, and down to the time of paying the money, and the delivery of the deed; and if notice is specially charged, the denial must be of all circumstances referred to, from which notice can be inferred; and the answer or plea show how the grantor acquired title. * * * The title purchased must be apparently perfect, good at law, a vested estate in fee simple. * * * It must be by a regular conveyance; for the purchaser of an equitable title holds it subject to the equities upon it in the hands of the vendor, and has no better standing in a court of equity. * * * Such is the case which must be stated to give a defendant the benefit of an answer or plea of an innocent purchase without notice; the case stated must be made out, evidence will not be permitted to be given of any other matter not set out.'"
> (Citing numerous additional authorities.)

Even if it be considered, therefore, that Mr. Stilson's statement as to what is in the schedule is competent evidence of the fact that the stock had been hypothecated, there is no evidence at all that it had passed to a *bona fide* purchaser for value without notice, and therefore it fails to establish any defense to our right of rescission.

The court further in its opinion apparently recognizes that the secured note was taken in lieu of cash and that thereby the Staats Company confirmed the sale. This simply means, as we have pointed out, that the title then passed. This being true there could be no preference. The sale was actually made in contemplation of law when the secured note was accepted and we gave as consideration therefor the title to the stock. This, too, is apparently conceded in the opinion, where the court says, referring to the effect of accepting the note and deed of trust:

> "It was the sale and delivery of 60 shares of stock and they became part of the general assets of the Stilson Company."

That is true, but they became part of the assets only because we allowed title thereto to pass in consideration of the receipt of the secured note. It was, therefore, a sale made in consideration of the execution and delivery of the note and deed of trust. Once it is appreciated, as we trust we have now made clear, that up to the time of the execution and acceptance of the secured note title to the stock remained in the Staats Company, and it had a right to retake it, then it seems to us that it follows necessarily that the transaction did not, and could not, constitute a preference.

We regret the necessity of having thus extended this petition for rehearing. We have felt, however, that we must have failed to make clear the true situation in our original brief, and that it was only fair to the court, as well as to our clients, to endeavor to the best of our ability to make it clear in this petition. In closing we wish to call the attention of the court to this fact, that the decision heretofore rendered by the court practically confirms the fraud of Stilson. He endeavored fraudulently, by giving a bad check in what was a cash transaction, to secure the stock without paying for it. If the decision heretofore rendered is allowed to stand that very situation is brought about and confirmed. That this would be most unjust and inequitable must be obvious. That the law does not require it has, we trust, been shown in this petition. Indeed, we feel, with all due respect, that it can fairly be asserted that under the principles we have endeavored to elucidate the law requires exactly the opposite ruling. We, therefore, submit and urge most respectfully, but most earnestly, that this petition for rehearing should be granted, and that the judgment of the learned District Court should be affirmed.

We annex hereto a copy of the opinion originally rendered by this court.

Respectfully submitted,

O'Melveny, Stevens & Millikin,
Walter K. Tuller,
*Attorneys for Appellees.*

## Certificate of Counsel.

The undersigned, attorneys of this court and counsel for appellees in the above cause, hereby certify that in the judgment of them and each of them the foregoing petition for rehearing is well founded and further certify that the same is not interposed for delay.

Henry W. O'Melveny.
E. E. Millikin.
H. J. Stevens.
Walter K. Tuller.

## APPENDIX.

United States Circuit Court of Appeals for the Ninth Circuit.

Security Trust & Savings Bank, a corporation, as trustee in bankruptcy of Fielding J. Stilson Company, a corporation, bankrupt, appellant, vs. Wm. R. Staats Company, a corporation, and Title Insurance & Trust Company, a corporation, appellees.

In equity. No. 2691.

OPINION, UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

Upon appeal from the United States District Court for the Southern District of California.

This is a suit in equity between the Security Trust & Savings bank, a corporation, trustee in bankruptcy of the estate of Fielding J. Stilson Company, a bankrupt corporation, and William R. Staats Company and Title Insurance & Trust Company, corporations.

The complaint alleges: That upon July 2, 1912, petition in involuntary bankruptcy was filed against the Stilson Company, and on October 24, 1912, the Stilson Company was adjudged a bankrupt; that on March 12, 1912, the Staats Company was a general unsecured creditor of the Stilson Company for $3,870; that the Stilson Company was then insolvent, and the Staats Company knew. and had reasonable cause to believe, that the Stilson Company was insolvent; that on March 19, 1912, the Stilson Company made and delivered to the Title Insurance & Trust Company a deed of trust for certain realty in Los Angeles, which was recorded on March 20, 1912, and was received as security for the indebtedness of $3,870 due by the Stilson Company to the Staats Company; and it is alleged that the effect of the conveyance was to enable the Staats Company to

receive a greater percentage of its indebtedness than any other creditors of the same class, and that the conveyance was made by the Stilson Company to give the Staats Company a preference in violation of the bankrupt statutes.

The trustee prays that the conveyance be vacated and declared void and that it be decreed that neither the Staats Company nor the Title Insurance Company has any right to the property described in the conveyance.

The Staats Company and the Title Insurance & Trust Company. by answer, admitted the execution and delivery of the conveyance, but denied that it operated as a preference, and set up that the Staats Company was a creditor of the Stilson Company and that the deed of trust was made under these circumstances: That on the 19th of March, 1912, and for months before then, the Stilson Company and the Staats Company were stock brokers in Los Angeles; that on March 15, 1912, the Stilson Company asked the Staats Company to sell it for cash certain shares in the Amalgamated Oil Company at $64.50 per share, and that the Staats Company sold to the Stilson Company 60 shares at $64.50, and delivered the certificates of stock to the Stilson Company with an understanding and agreement between the Stilson Company and the Staats Company that the sale was made for cash; that the Stilson Company then delivered to the Staats Company its check on a bank in Los Angeles in payment for the stock, and that in due course the Staats Company presented the check, but was notified that the Stilson Company had no funds wherewith to pay the check, and that it had not had funds wherewith to pay the check when the same was drawn, and that payment was refused; that the Staats Company notified the Stilson

Company of the refusal of the bank to pay the check, but that the Stilson Company assured the Staats Company that the Stilson Company was sound, but that certain funds which it had expected to receive had been slightly delayed in receipt, and that, for that reason, there were not funds on deposit sufficient to pay the check; that the Stilson Company then agreed that if the Staats Company would not exercise its right to rescind the sale, the Stilson Company would execute to the Staats Company its note for $3,870, and to secure the note would make a deed of trust on the property described in the deed of trust heretofore referred to; that in pursuance of such agreement, the Staats Company refrained from exercising its right to rescind the sale, and accepted from the Stilson Company its note for $3,870, and the deed of trust referred to. Good faith on the part of the Staats Company is pleaded, and it is averred that a present fair consideration passed from the Staats Company to the Stilson Company for the deed of trust.

Over the objections of the defendants below (the Staats Company and the Title Insurance & Trust Company), the matter was referred to a special master to hear the issues raised by the complaint and the answer and to report the same to the District Court together with findings of fact and conclusions of law. Thereafter the special master made his findings to the effect that on March 19, 1912, the Stilson Company was insolvent; that the transfer made by the Stilson Company to the Title Insurance & Trust Company was made and received as security for an indebtedness of $3,870 then due by the Stilson Company to the Staats Company, and that the effect of the transfer was to enable the Staats Company to obtain a greater percentage of its claim against the bankrupt than other

creditors of the bankrupt of the same class, and that the Staats Company, when it received the transfer, had reasonable cause to believe that it was intended by the giving of the transfer to give a preference, and that the transfer was voidable at the instance of the trustee.

The Staats Company and the Title Insurance & Trust Company, defendants below, filed exceptions to the findings and report of the special master. The District Court, after overruling several exceptions and sustaining others, dismissed the complaint. From the judgment of dismissal the Security Trust & Savings Bank, as trustee of the Stilson Company, bankrupt, appeals.

Before Gilbert, Ross, and Hunt, circuit judges.

Hunt, circuit judge, after stating the facts:

The appellant contends that the court erred in sustaining the exceptions of the defendants:

To the finding of the special master that the deed of trust operated to enable the Staats Company to obtain a preference;

To the finding that the deed of trust was executed to secure an antecedent debt, and that the transaction between the Stilson Company, bankrupt, and the Staats Company, was not a single transaction;

To the finding that the 60 shares of stock had been hypothecated by the bankrupt prior to the execution of the trust deed; and

To the finding that the Staats Company, at the time of the execution of the deed of trust, had reasonable cause to believe that a preference was intended.

The history of the transaction involved, as gathered from the evidence, is in accord with the findings of the special master, and may be briefly stated as follows:

The Stilson Company was adjudged a bankrupt on October 24, 1912, upon an involuntary petition filed on

July 2, 1912. The particular act which was made the basis of the adjudication in bankruptcy was that about March 14, 1912, while the Stilson Company was insolvent, it conveyed certain of its real property in Los Angeles to the William R. Staats Company with intent to hinder and delay the creditors of the Stilson Company, and with intent to prefer the Staats Company over other creditors of the bankrupt. In due course of proceedings in the bankruptcy court it was there found that on March 15, 1912, the Stilson Company was indebted in the sum of more than $250,000, and that it had at that time assets of no greater value than $215,000; and that on the 19th of March, when insolvent, the Stilson Company had conveyed the realty heretofore referred to to the Staats Company, then a creditor of the Stilson Company, with intent to prefer the Staats Company over its other creditors; and that the effect of the transfer was to enable the Staats Company to receive payment of a greater percentage of its debt than any other unsecured creditor of the bankrupt.

In the present suit it was found by the special master, and the evidence well sustains the finding, that on March 15, 1912, the Stilson Company, in due course of business, bought from the Staats Company 200 shares of Amalgamated Oil Company stock at $64.50 per share. The Staats Company delivered certificates representing 60 shares, and gave a broker's due bill for 140 shares for subsequent delivery. On that day, March 15th, the bankrupt, to pay for the shares, gave its check for $12,900 to the Staats Company, payable at the Citizens' National Bank of Los Angeles, but on presentation of the check to the bank it was rejected for want of funds and was returned. On March 16th, Mr. Jardine, vice-president of the Staats Company, had

a talk with Mr. F. J. Stilson, president of the Stilson Company, concerning the rejected check, and was told by Stilson that the check would be made good, and Stilson asked that it be put through the bank again. On Monday, March the 18th, the check was again presented at the bank, but rejected; and thereafter, again, on the 18th of March, Stilson, of the Stilson Company, asked an officer of the Staats Company to put it through the bank once more; but again it was rejected by the bank for want of funds to the credit of the Stilson Company. Thereupon, at a conference between Mr. Jardine, of the Staats Company, and Mr. Stilson, of the Stilson Company, Stilson said he expected payment of $10,000 upon some real estate and that he would first take care of the "item" with the Staats Company; but on the 19th of March, Stilson advised the Staats Company that he could not meet the payment, as the expected funds did not materialize, but that the Stilson Company had some realty in Los Angeles and would give the Stilson Company's equities as security. An employee of the Staats Company then went with Stilson to examine the real property offered as security, with the result that the real estate was accepted as security, and a trust deed was given by the Stilson Company on the afternoon of the 19th to the Title Insurance & Trust Company for the benefit of the Staats Company to secure a promissory note due one day after date in the sum of $3,870, the price of the 60 shares of stock of the Amalgamated Oil Company which had been delivered by the Staats Company to the Stilson Company. On March 20th, at 9 o'clock, this deed of trust was put on record, and on that same morning the Stilson Company suspended, and thereafter did no business.

The evidence also sustains the finding to the effect

that the due bill for the 140 shares which had been given by the Staats Company to the Stilson Company, and the 60 shares also, had been hypothecated by the Stilson Company, and there is no evidence to show that when the Staats Company agreed to give the Stilson Company time to obtain the money wherewith to meet its obligations, there was any suggestion of holding onto the stock which the Staats Company had sold to the Stilson Company. The Staats Company, with full knowledge of the rejection of the check, and without any then apparent thought of retaining a lien on the shares, expressly agreed with the Stilson Company to wait and again to put the check through the bank, and did so twice after it had first been rejected.

We agree with the special master in holding that when the Staats Company accepted the mortgage it was in lieu of cash, and that the transaction became one where the debtor, to secure an existing antecedent debt due by it to the creditor, gave security, and the creditor, confirming the sale, accepted the security. We do not think that the transaction can be looked upon as a new and present advancement to the Stilson Company: it was a sale and delivery of the 60 shares of stock, and they became part of the general assets of the Stilson Company.

The evidence shows that the effect of the enforcement of the mortgage given by the Stilson Company when insolvent would be to give to the defendant the Staats Company a greater percentage of its claim against the bankrupt than other creditors of the same class, and under the facts the bankrupt must be held to have given a preference by the giving of such security to the Staats Company.

Our further view is that the evidence sustains the finding of the special master to the effect that when

the Staats Company received the trust deed from the Stilson Company it had reasonable cause to believe that it was intended to give a preference. There is ample evidence to show that the Staats Company must have known of the financial stress of the Stilson Company. Its officers knew when the mortgage was given that the Stilson Company then had checks outstanding, but rejected, and that the intent of the Stilson Company was to secure the Staats Company for the price of the 60 shares, it being in evidence that the Staats Company only wanted security for the 60 shares and did not recognize the due bill for 140 shares. We must affirm the view of the special master in his conclusions that all the circumstances surrounding the transaction must have caused the Staats Company to believe that the Stilson Company was insolvent and that the effect of the mortgage would be to prefer the Staats Company; and we hold that the master was correct in finding that it was intended that the transaction should operate as a preference. Sundheim v. Ridge Avenue Bank, 138 Fed. 951; *In re* Dorr, 196 Fed. 292; Hotchkiss v. National City Bank, 201 Fed. 664, 231 U. S. 50.

Finally, we believe that the Staats Company became a general creditor of the bankrupt and that the transaction was broken in its continuity when the Staats Company agreed to wait for its money and to send the check through the bank the second and third time, and when it agreed to wait to see whether the bankrupt would obtain money which its agents said was expected from the sale of certain other property, no effort having been made by the Staats Company to prevent the shares of stock which had been sold and delivered to the Stilson Company from passing out of the hands of the Stilson Company. That part of the argument made by the appellee in support of the action

of the District Court wherein the point is made that the giving of the check by the Stilson Company was a representation that that corporation had sufficient funds to meet the check, and that, such representation not being true, a fraud was perpetrated on the Staats Company, and that title remained in the Staats Company and did not pass until the note and deed of trust were accepted, has received our careful consideration. But whatever right of rescission existed because of misrepresentation by the Stilson Company in giving the check, was abandoned by the position taken when security was accepted for the purchase money. Joslin v. Cowee, 52 N. Y. 90; Amer v. Hightower, 70 Cal. 440; Wendling Lumber Company v. Glenwood Lumber Company, 153 Cal. 411.

The order of the District Court sustaining the exceptions to the report of the special master and dismissing the bill is reversed, and the cause is remanded with directions to overrule the exceptions to the report of the master and to enter a judgment in favor of the complainant.

(Endorsed): Opinion. Filed May 8, 1916. F. D. Monckton, clerk.

A true copy.

Attest, May 10, 1916.

(Seal) F. D. MONCKTON, *Clerk.*

By PAUL P. O'BRIEN, *Deputy Clerk.*